

A Consultative Document

on Auditors' Roles and Responsibilities

by the Corporate Law Reform Committee
for the Companies Commission of Malaysia



SURUHANJAYA SYARIKAT MALAYSIA
COMPANIES COMMISSION OF MALAYSIA

C o n t e n t s

Section A: Foreword	Page
1. Foreword	5
Section B: Executive Summary	
1. Background	13
2. Summary of Proposals	13
Section C: Auditors' Roles and Responsibilities	
1. Introduction	19
2. Appointment, Removal, Resignation and Non-Renewal of Appointment of Auditors and Auditors' Rights and Duties	20
3. Oversight of the Auditing Profession	39

COMPANY LAW
CORPORATE LAW REFORM COMMITTEE
A CONSULTATIVE DOCUMENT ON
AUDITORS' ROLES AND RESPONSIBILITIES

DECEMBER 2007

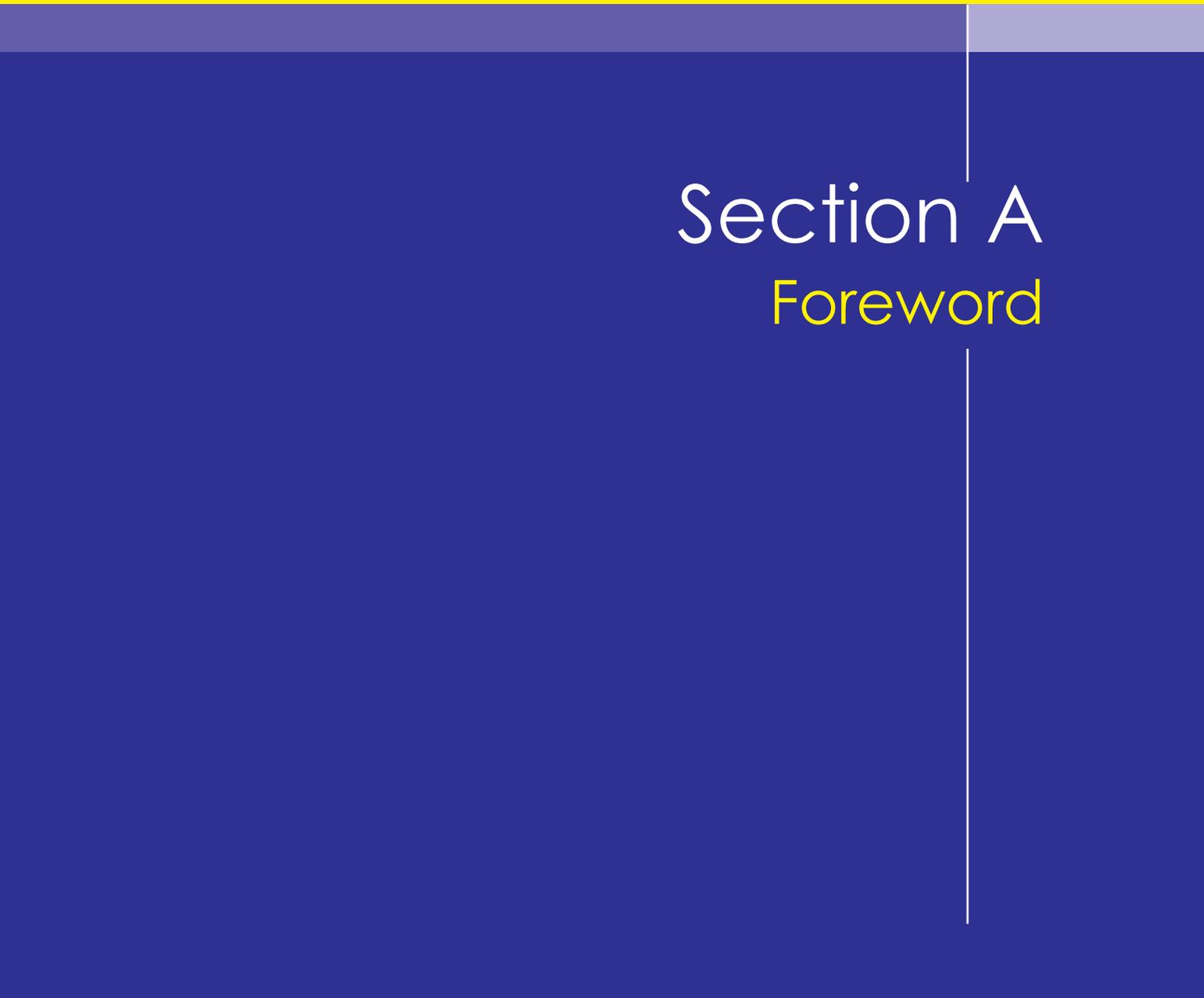
The Corporate Law Reform Committee invites comments, by **21 January 2008** on the issues set out in this consultative document.

You are invited to send comments, together with any supporting evidence on any part of this consultation. We would be grateful if you could refer to the recommendation number(s) and/or paragraph number(s) in your feedback, preferably by email, to:

Nor Azimah Abdul Aziz
Secretary,
Corporate Law Reform Committee
Companies Commission of Malaysia
17th Floor, Putra Place
100 Jalan Putra
50622 Kuala Lumpur
e-mail : azimah@ssm.com.my
Fax : 603-40476334

Additional copies of this document may be made without seeking permission from the Companies Commission of Malaysia or downloaded from its website at www.ssm.com.my.

Confidentiality: Your responses may be made public by the CLRC. If you do not want all or part of your response or name made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only if you request that the information remain confidential.



Section A
Foreword

SECTION A - FOREWORD

It is an established rule that the auditors are to play a vigilant and objective role in ensuring that the shareholders' interests are well protected and that the management of the company have acted within reason. It is the shareholders who primarily depend on the good faith and efficiency of the company's auditor to ensure that company's actions in the day-to-day operations are verified.

Due to the importance and increasing responsibilities placed on auditors, the recommendations contained in this Consultative Document covers issues pertaining to the rights and duties of the auditors, the appointment, removal, and resignation etc. Some examples of issues discussed in this Consultative Document are on the mandatory audit rotation and whether there is a need to codify the current self-regulatory approach on mandatory audit. In addition, the Consultative Document also touches on the steps to be taken by the auditor to effect his resignation and also the establishment of an independent Auditing Oversight Body.

We hope to receive views and comments on the recommendations stated in this Consultative Document. Please reply to Nor Azimah Abdul Aziz at the Companies Commission of Malaysia (SSM) by **21 January 2008**.

Thank you.

Yours truly,

Dato' K.C. Vohrah

Chairman

Corporate Law Reform Committee

Dato' Dr. Nik Ramlah Nik Mahmood

Chairperson

Working Group C

MEMBERS OF THE CORPORATE LAW REFORM COMMITTEE (CLRC)

1. Y. Bhg. Dato' K.C. Vohrah (Chairman)
Consultant
2. Y. Bhg. Datuk Dr. Abdul Samad Hj Alias
Chartered Accountant
3. Y. Bhg. Dato' Loh Siew Cheang
Advocate & Solicitor
4. Y. Bhg. Datuk Simon Shim Kong Yip (w.e.f 1 October 2005)
Advocate & Solicitor
5. Abdul Karim Abdul Jalil (w.e.f 1 November 2005)
Chief Executive Officer, Companies Commission of Malaysia
6. Dato' Dr. Nik Ramlah Nik Mahmood
Representative of the Securities Commission
7. Selvarany Rasiah
Representative of Bursa Malaysia Securities Berhad
8. Charon Wardini Mokhzani
Deputy Chief Executive, CIMB Investment Bank Berhad
9. Philip Koh Tong Ngee
Advocate & Solicitor
10. Peter Lee Siew Choong
Advocate & Solicitor

11. Cheong Kee Fong
Advocate & Solicitor
12. Lim Tian Huat
Chartered Accountant
13. Eric Kang Shew Meng
Company Secretary Practitioner
14. Prof. Dr. Khaw Lake Tee
Universiti Malaya
15. Assoc. Prof. Aishah Bidin
Universiti Kebangsaan Malaysia
16. See Mee Chun (w.e.f 17 October 2005)
Representative of the Attorney General's Chambers
17. Aslam Zainudin (w.e.f. 13 July 2004)
Representative of the Prime Minister's Department
18. Ahmad Azhari bin Abd Hamid (w.e.f. 15 August 2006)
Representative of the Prime Minister's Department

MEMBERS OF WORKING GROUP C

1. Dato' Dr. Nik Ramlah Nik Mahmood (Chairperson)
Representative from the Securities Commission
2. Dato' K.C. Vohrah (Chairman of CLRC)
Consultant
3. Assoc. Prof. Dr Aishah Bidin
University Kebangsaan Malaysia
4. Selvarany Rasiah
Representative from Bursa Malaysia
5. Yew Yee Tee
Representative from Bursa Malaysia
6. Philip Koh Tong Ngee
Advocate & Solicitor
7. Peter Lee Siew Choong
Advocate & Solicitor
8. Dato' Loh Siew Cheang
Advocate & Solicitor
9. Peter Ling
Advocate & Solicitor
10. Dato' Ahmad Johan Mohammad Raslan
Executive Chairman
PricewaterhouseCoopers, Malaysia
11. Shanti Geoffrey
Representative from the Securities Commission

12. Datuk Simon Shim Kong Yip
Advocate & Solicitor
13. See Mee Chun
Representative of the Attorney General's Chambers

MEMBERS OF THE SECRETARIAT (CLRC)

Consultant

Assoc. Prof. Dr. Aiman Nariman Mohd Sulaiman
*Ahmad Ibrahim Kulliyah of Laws
International Islamic University Malaysia*

Secretariat

Nor Azimah Abdul Aziz
Secretary

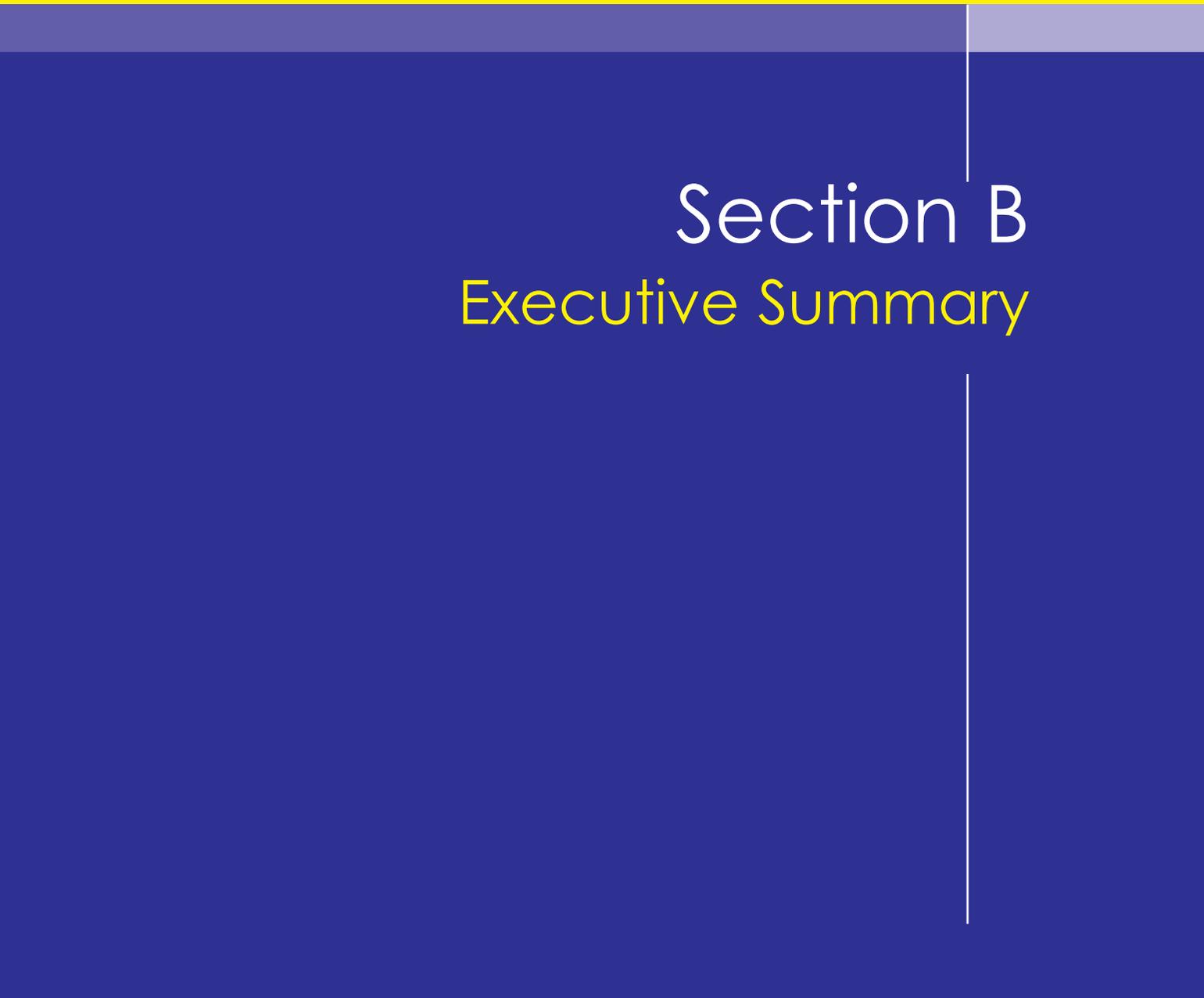
Norhaslinda Salleh
*Section Head
Corporate Development and Policy Division*

Norhaiza Jemon
Corporate Development and Policy Division

Sapiah Ambo
Corporate Development and Policy Division

Marina Nathan
Corporate Development and Policy Division

The Secretariat can be contacted at:-
+ 603 4047 6062 / 6063 / 6064
clrc@ssm.com.my



Section B
Executive Summary

SECTION B - EXECUTIVE SUMMARY

1 BACKGROUND

- 1.1 Auditors play an integral part in a company as the company's financial standing reflects the actual health of a company. In this consultative document, the CLRC has considered the need to revise statutory provisions relating to the appointment, removal and resignation of auditors of public and private companies at the same time taking into consideration the recommendations put forward under the Consultative Documents titled '*Creating a Conducive Legal and Regulatory Framework for Businesses*' (CD 7) and '*Engagement with Shareholders*' (CD 3).

2. PROPOSALS

- 2.1 *Appointment, Removal, Resignation and Non-Renewal of Appointment of Auditors:* It is the recommendation of the CLRC that:
- (a) the existing requirement as to the appointment of an auditor for both public and private companies should be retained if the mandatory audit is retained. However, if audit or AGM is no longer required for private companies, the auditors are to be appointed by directors if shareholders do not appoint them and the duration of appointment of auditors is in accordance to the terms of appointment or until they are removed by shareholders at a general meeting or until they resign.
 - (b) in the case of the resignation of auditors, the current statutory provision that requires the resignation to be effective upon the appointment of a new auditor and only if the resignation is made at the general meeting, should be deleted. The effective date of resignation would be at the end of 21 days from the time the notice is deposited with the company. The directors must proceed duly within 21 days from the date of the deposit of a notice of resignation to convene a meeting for a day not more than 28 days after the

date on which the notice convening the meeting is given. Every director who failed to take all reasonable steps to secure that a meeting was convened as mentioned above is guilty of an offence and liable to a fine.

- (c) where the auditor resigns, the auditor should be required to submit the resignation statement to the company in addition to the duty to inform the regulators upon ceasing to hold office as the auditor and the company should be required to provide the shareholders with the statement. The auditor is required to either state that there are no circumstances connected with his or her resignation that need be brought to the attention of members or creditors of the company, or to set out what are the circumstances for his resignation to be circulated by the company.
- (d) the existing provision on removal of auditor is to be retained.
- (e) there should not be a codification of the mandatory rotation of audit firms and that rules relating to mandatory audit rotation should continue to be a matter of best practice.

2.2 *Auditors' Rights and Duties:*

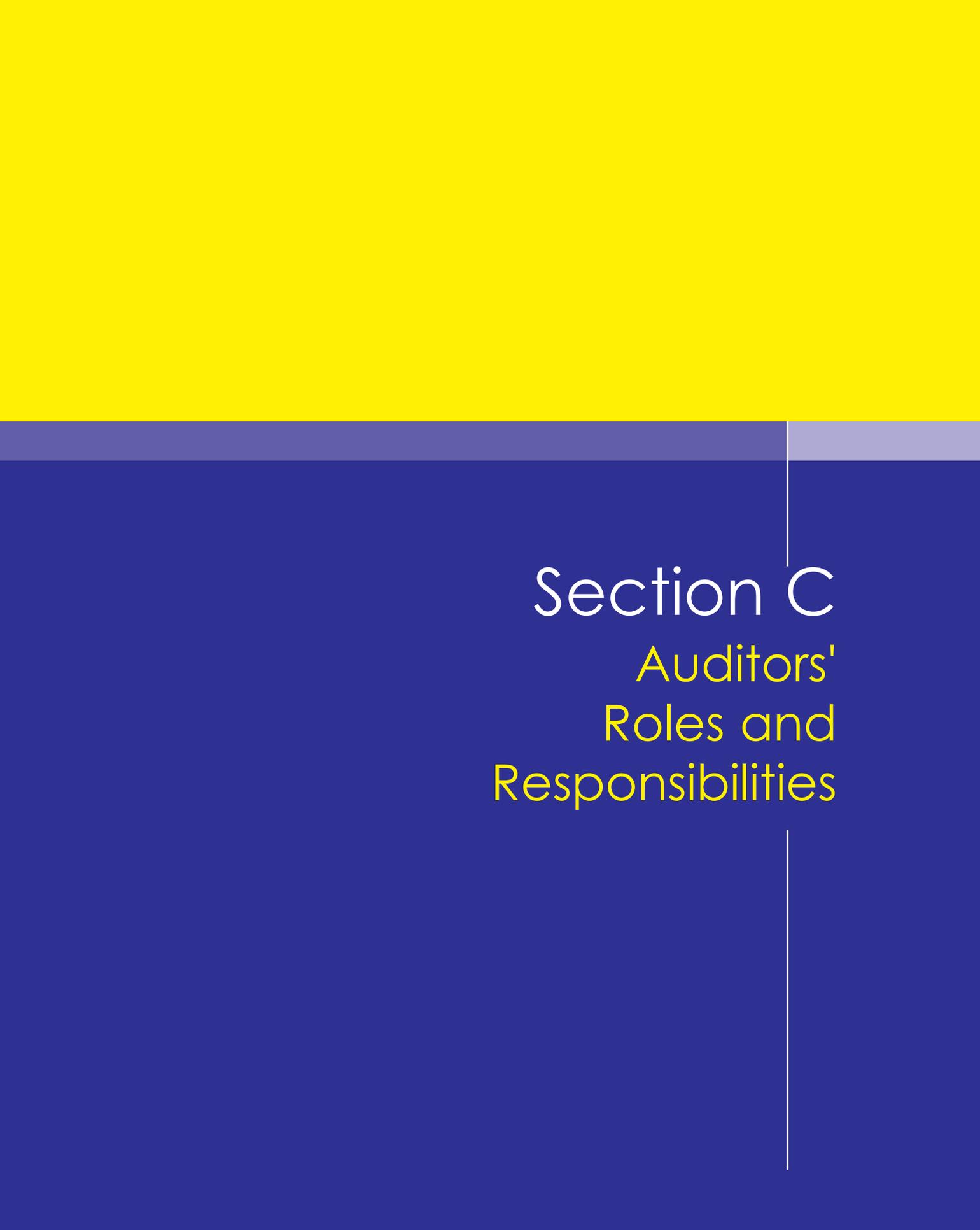
It is the recommendation of the CLRC that:

- (a) the statutory provision relating to rights of an auditor in relation to access to the company's information, the right to attend general meetings and be heard on any part of the business of the meeting to which the audit relates be retained; and
- (b) the current regime that relies on statute to state the general duty of auditors to report whether the accounts give a true and fair view of the company's financial position while relying on best practice and self-regulation to provide guidance on how the assessment of whether the accounts give a true and fair view of the company's financial position should be retained.

2.3 *Oversight of the Auditing Profession:*

It is the recommendation of the CLRC that consideration should be given to the establishment of an independent Auditing Oversight Body. This proposed body would have some features similar to that of the Public Company Accounting Oversight Body (PCAOB) of the United States. It is proposed that the members of this body should comprise persons other than members from the professional accounting bodies such as regulators, investor associations and industry associations. This proposed broad based membership is to ensure that public interest will be adequately represented in the proposed body. This proposed body should be responsible for all matters pertaining to the audit industry or whether its remit be confined only to non-licensing matters as licensing of auditors is already dealt with by section 8 of the Companies Act 1965. Matters which should be within the scope of functions of the oversight body would include those referred to above. This proposed body will co-exist with professional accounting bodies which would be responsible for the professional functions of the audit profession.

This Page Is Intentionally Left Blank



Section C

Auditors' Roles and Responsibilities

SECTION C - AUDITORS' ROLES AND RESPONSIBILITIES

1 BACKGROUND

- 1.1 As an integral component of the legal and regulatory framework affecting companies, audit provides reasonable assurance as to the truth and fairness of a company's financial information and increases the reliability of accounts due to the independent third party verification. In Malaysia, the laws governing audit and auditors are the Companies Act 1965, the provisions of the Listing Requirements of the Stock Exchange and the Bye-laws (on professional conduct and ethics) issued by the Malaysian Institute of Accountants.

- 1.2 Cross-jurisdictional study indicates that some jurisdictions provide exemption from audit and thus, exemption from having to lay the audited accounts at the general meeting for certain categories of companies. The CLRC has published its consultative document entitled "*Creating A Conducive Legal and Regulatory Framework for Businesses*" (CD 7) where views from the public were sought on, amongst others, the retention of the mandatory audit for public companies and private companies. The CLRC has also published its consultative document entitled "*Engagement with Shareholders*" (CD 3) to obtain views on doing away with AGMs for private companies and recommended that private companies need not be required to hold an AGM. In this paper, the CLRC considered the need to revise the current statutory provisions in relation to the appointment, removal and resignation of auditors of public and private companies, taking into consideration the recommendations put forward under these consultative documents.

2 APPOINTMENT, REMOVAL, RESIGNATION AND NON-RENEWAL OF APPOINTMENT OF AUDITORS

A Auditors' Appointment

- 2.1 Currently, every company must have its accounts audited and must appoint an auditor or auditors. The first auditor is appointed by the board of directors. The board also has the authority to appoint an auditor where there is a casual vacancy.¹ However, the shareholders in a general meeting may appoint an auditor if the board does not appoint the auditor.² The auditors may also be appointed by the Registrar where the company fails to do so provided there is an application in writing made by any member of the company.³
- 2.2 The first auditors may be appointed before the first annual general meeting (AGM) by the board of directors. At the first AGM, the existing auditors may be reappointed or new auditors may be appointed in place of the outgoing auditors. Subsequent auditors are appointed by shareholders at each subsequent AGM.⁴ The first auditor appointed by the board remains as auditor until the expiration of the first AGM of the company. The auditor appointed by the company at the first AGM remains in office until the conclusion of the next AGM. At the conclusion of an AGM, the company may appoint a different auditor or reappoint the outgoing auditor. Where the outgoing auditor is reappointed, there is no statutory provision restricting the number of times that a reappointment may be made. There is no statutory requirement for mandatory rotation of audit firm although mandatory rotation of audit partner of

¹ Section 172(3) "Subject to subsections (7) and (8), the directors of a company may appoint an approved company auditor to fill any casual vacancy in the office of auditor of the company, but while such a vacancy continues the surviving or continuing auditor or auditors, if any, may act. A casual vacancy occurs due to the death or incapacity of any of the auditors.

² Section 172(1) of the Companies Act 1965 " At any time before the first annual general meeting of a company, the directors of the company may appoint, or (if the directors do not make an appointment) the company at a general meeting may appoint, a person or persons to be the auditor or auditors of the company, and any auditor or auditors so appointed shall, subject to this section, hold office until the conclusion of the first annual general meeting ". See section 172(2) of the Companies Act 1965.

³ Section 172(10) of the Companies Act 1965.

⁴ A company shall at each annual general meeting of the company appoint a person or persons to be the auditor or auditors of the company, and any auditor or auditors so appointed shall, subject to this section, hold office until the conclusion of the next annual general meeting of the company.

listed entities or public interest entities is required under the MIA Bye-laws. In addition to the statutory provisions, the Bursa Malaysia Securities Berhad Listing Requirements⁵ requires listed companies to appoint a suitable accounting firm to act as its external auditors. The listed company is also required to establish an audit committee with the functions, amongst others, to review the financial reporting of the company, review the internal control, review the internal audit and review the external audit of the company.

2.3 It is noted that the current law does not distinguish between public and private companies unlike other jurisdictions that have allowed for audit exemption for certain categories of private companies. In these jurisdictions, there are different rules relating to the appointment of auditors of public companies and auditors of private companies.

2.4 In the United Kingdom, audit exemptions are provided for certain types of companies. However, the members of the company may still require that the company's accounts be audited. Prior to the UK Companies Act 2006, in the case of a private company which has elected to dispense with the laying of accounts, the appointment shall be made within 28 days after the day on which copies of the accounts are to be sent to members of the company.⁶ A private company is also allowed to elect to dispense with the appointment of auditors annually, in which case the auditor's appointment continues for each succeeding financial year until a resolution is passed terminating their appointment. However, the UK Companies Act 2006 now provides that a private company may be exempted from having its accounts audited⁷ although these companies are free to appoint an auditor if they

⁵ Part D, Paragraph 15.22, Bursa Malaysia Securities Berhad Listing Requirements 2001.

⁶ Section 385A of the UK Companies Act 1985.

⁷ See section 475 of the UK Companies Act 2006.



wish to do so or if members request that the accounts be audited.⁸ Nonetheless, section 485 provides that an auditor or auditors of a private company must be appointed for each financial year of the company, *unless* the directors reasonably resolve otherwise on the ground that audited accounts are unlikely to be required. The appointment must be made before the end of the period of 28 days beginning with-

- (a) the end of the time allowed for sending out copies of the company's annual accounts and reports for the previous financial year (under section 424), or
- (b) if earlier, the day on which copies of the company's annual accounts and reports for the previous financial year are sent out under section 423.

The appointment of an auditor for a private company⁹ or for a public company¹⁰ may be made by the directors, by the members or by the Secretary of State. The directors may appoint an auditor at any time before the company's first period for appointing auditors (as stated under section 485), or following a period during which the company (being exempt from audit) did not have any auditor, at any time before the company's next period for appointing auditors, or to fill a casual vacancy. The members may appoint the auditor during a period for appointing auditors (as stated under section 485), if the company should have appointed an auditor or auditors during a period for appointing auditors but failed to do so, or where the directors had power to appoint but have failed to make an appointment. The auditor or auditors of a private or public company hold office in accordance with the terms of their appointment, subject to the requirements that-

- (a) they do not take office until the previous auditor or auditors have ceased to hold office, and

⁸ Section 476 of the UK Companies Act 2006.

⁹ Sections 485 and 486 of the UK Companies Act 2006.

¹⁰ Sections 489 and 490 of the UK Companies Act 2006.



- (b) they cease to hold office at the conclusion of the accounts meeting next following their appointment, unless re-appointed. However for a private company, where no auditor has been appointed by the end of the next period for appointing auditors, any auditor in office immediately before that time is deemed to be re-appointed at that time, unless-
- (i) he was appointed by the directors, or
 - (ii) the company's Articles require actual re-appointment, or
 - (iii) the deemed re-appointment is prevented by the members under section 488,¹¹ or
 - (iv) the members have resolved that he should not be re-appointed, or
 - (v) the directors have resolved that no auditor or auditors should be appointed for the financial year in question.

These provisions do not affect the statutory provisions that relate to the removal and resignation of auditors. In addition, the professional guidance was changed so that there is a requirement for rotation of the audit engagement partner for listed companies at least every five years and of other key audit partners of listed companies every five years.¹²

- 2.5 The Australian Corporations Act 2001 provides exemption to certain proprietary companies from the audit requirement. However, these companies may appoint an auditor. The appointment may be made by the directors, if the members at the general meeting have not done so.¹³ A public company shall appoint an auditor within the first month after the company is incorporated and the appointment is to be made by the directors unless the company has appointed the auditor in its first

¹¹ The section provides that members representing at least the requisite percentage (5 percentage, or such lower percentage as is specified in the company's Articles) of the total voting rights of all members who would be entitled to vote on a resolution may send a notice to the company that the auditor should not be re-appointed.

¹² As a result of the recommendations of DTI and Treasury, *Report of the Co-ordinating Group on Audit and Accounting Issues*, URN 03/567 (January 2003).

¹³ Section 325 of the Corporations Act 2001.

AGM.¹⁴ The appointment of the first auditor(s) of a public company ceases at the first AGM. Subsequent appointments to fill in the vacancy are to be made by shareholders at each AGM. Where there is a casual vacancy, the board of directors must make a new appointment and the auditor holds office until the next AGM. However, the board has no authority to fill in the casual vacancy if this arises due to the general meeting's decision to remove an auditor. In such a case, the new auditor must be appointed at the same meeting by a special resolution of the shareholders provided that the notice of nomination has been given to the proposed auditor. If the appointment cannot be made at the same meeting, the meeting may be adjourned and the new auditor may be appointed at the adjourned meeting by an ordinary resolution.¹⁵ In the case of a listed company, the appointment of auditor(s) is to be made with the recommendation of an audit committee. If the company fails to appoint a new auditor in accordance with this procedure, the ASIC may appoint an auditor. ASIC also has the power to appoint an auditor of a public company if the company fails to do so and a request is made by a member of the company for ASIC to do so. Where audit rotation and maximum period of appointment is concerned, the CLERP 9 Act 2004 introduced the rule that there should be mandatory rotation of an audit partner after five years and the auditor should not continue to play a significant role in the audit of the company for any successive years without a two-year interval. ASIC may make a declaration that the fact that the audit partner is playing a significant role in the audit is to be disregarded.¹⁶

¹⁴ Section 327A of the Corporations Act 2001.

¹⁵ Sections 327D and 327E of the Corporations Act 2001.

¹⁶ Section 324DA of the Corporations Act 2001. In Australia, the Ramsay Report recommended that there should be a mandatory rotation of the audit partners responsible for the audit of listed companies. The rotation is to occur after a maximum of 7 years but may occur sooner if considered appropriate by those involved in the audit. There is to be a period of at least 2 years before the partner can again be involved in the audit of the client. See the following: (a) Report of the Working Party of the Ministerial Council for Corporations (MINCO) "Review of the Requirements for the Registration and Regulation of Company Auditors" (July 1997) (b) Ian Ramsay, "Independence of Australian Company Auditors", Report to the Minister for Financial Services and Regulation, Department of the Treasury, Canberra, 2001 (The Ramsay Report) (c) the Australian CLERP 9, *Corporate Disclosure - Strengthening the Financial Reporting Framework*.

- 2.6 In relation to the appointment of auditor and duration of appointment, in view of the CD 3 and CD 7, the CLRC is of the view that:
- (a) in the case of a public company, the current statutory provisions and the Bursa Malaysia Securities Berhad Listing Requirements on an auditor's appointment should be retained.
 - (b) if the current mandatory audit regime for private companies is retained, the current statutory provision for an auditor's appointment should also be retained.
 - (c) if audit is no longer mandatory for private companies, the members may still require that the accounts be audited in which case the auditor is to be appointed by directors if shareholders do not appoint them and in relation to the duration of appointment of auditors for private companies, the duration is in accordance with the terms of appointment, until the auditor is removed by shareholders at the general meeting or until the auditor resigns.
 - (d) if an AGM is no longer mandatory for private companies, changes must be made to the current statutory provisions to de-link the appointment of auditors from the AGM.
- 2.7 The CLRC also deliberated on the mandatory audit rotation and whether there is a need to codify the current self-regulatory approach on mandatory audit. Where mandatory audit rotation is concerned, the CLRC is of the view the long period of time of acting as an auditor of a company may compromise the independence of an auditor. This threat is particularly relevant in the context of the audit of public companies and safeguards should be put in place in such situations to minimise such threat. Currently, the rules of the Malaysian Institute of Accountants (MIA) requires for the mandatory rotation of audit firms and states that -
- (a) the lead engagement partner should be rotated after a period of not more than five (5) years; and

- (b) a partner rotating after such period should not resume the role of lead engagement partner for that audit client until a further period of two (2) years has elapsed.

The CLRC is of the view that there should not be a codification of the mandatory rotation of audit firms and that rules relating to mandatory audit rotation should continue to be a matter of best practice.

B Removal, Resignation and Non-renewal of Auditors

- 2.8 Currently, an auditor may only resign if he is not the sole auditor of the company and his resignation must be made at a general meeting of the company.¹⁷ If an auditor gives notice in writing to the directors of the company that he wishes to resign, the directors shall call a general meeting of the company as soon as it is practicable. This is for the purposes of appointing an auditor in place of the auditor who wishes to resign and to appoint another auditor. The resignation of the auditor shall take effect upon the appointment of another auditor.¹⁸
- 2.9 An auditor may only be removed by shareholders at the general meeting where notice of the intention to move the resolution to remove the auditor must be given to the company not less than 28 days before the meeting at which the resolution is to be moved. The auditor must be given a copy of the notice and he may make representations to the company dealing with his removal. The Bursa Malaysia Securities Berhad Listing Requirements¹⁹ requires that in the case of the removal of an

¹⁷ Section 172(14) of the Companies Act 1965.

" An auditor of a company may resign-
(a) if he is not the sole auditor of the company; or
(b) at a general meeting of the company,
but not otherwise."

¹⁸ Section 172(15) of the Companies Act 1965.

¹⁹ Paragraph 15.23, Listing Requirements 2001 of Bursa Malaysia Securities Berhad.



external auditor the listed issuer must forward to the Exchange a copy of any written representations made by the external auditors at the same time as copies of such representations are sent to members of the listed issuer under section 172(5)(b) of the Companies Act 1965, unless an order is made by the Registrar of Companies under section 172(6) of the Companies Act 1965. If the company did not appoint an auditor in place of the auditor so removed, the Registrar of companies will appoint an auditor but the auditor must consent to the appointment.

- 2.10 There are views that the current legal position in relation to the resignation and removal of auditors requires improvement. In relation to auditors' resignation, the Companies Act states that an auditor may resign if he is not the sole auditor and such resignation must be made at a general meeting. The resignation is also only effective when a new auditor is appointed by the company.
- 2.11 In the UK Companies Act 2006, an auditor of a company may resign his office by depositing a notice in writing to that effect at the company's registered office. The notice is not effective unless it is accompanied by the statement required by section 519. The auditor may deposit with the notice a signed requisition calling on the directors of the company to forthwith duly convene an extraordinary general meeting of the company for the purposes of receiving and considering such explanation of the circumstances connected with his resignation as he may wish to place before the meeting. The notice of resignation will be effective to end the auditor's term of office as of the date on which the notice is deposited or on such later date as may be specified in it.²⁰ The company shall within 14 days of the deposit of a notice of resignation send a copy of the notice to the registrar of companies. If

²⁰ Section 516(3) UK Companies Act 2006.

default is made in complying with this subsection, the company and officers who are in default are guilty of an offence and liable to a fine. If the directors do not within 21 days from the date of the deposit of a requisition under this section proceed duly to convene a meeting for a day not more than 28 days after the date on which the notice convening the meeting is given, every director who failed to take all reasonable steps to secure that a meeting was convened as mentioned above is guilty of an offence and liable to a fine. A company may by ordinary resolution at any time remove an auditor from office subject to a special notice of the resolution being given.²¹ Where a resolution removing an auditor is passed at a general meeting of a company, the company shall within 14 days give notice of that fact in the prescribed form to the Registrar. If a company fails to give the notice required by this subsection, the company and officers who are in default are guilty of an offence and liable to a fine and, for continued contravention, to a daily default fine. In addition, if a company does not want to reappoint the existing auditor, the UK Companies Act 2006²² requires that a resolution is proposed as a written resolution of a private company to appoint a person as auditor in place of a person (the "outgoing auditor") whose term of office has expired, or is to expire, at the end of the period for appointing auditors. In such a case, the company must send a copy of the proposed resolution to the person proposed to be appointed and to the outgoing auditor. The outgoing auditor may make written representations relating to the proposed resolution within 14 days after receiving the notice and request that the representation be circulated to members of the company. Where the auditor ceases to hold office, section 519²³ requires a statement for the reason of ceasing to hold office to be deposited with the company, submitted to the Registrar and

²¹ Section 510 of the UK Companies Act 2006.

²² Section 514 and 515 of the UK Companies Act 2006.

²³ Section 519 of the Companies Act 2006.

"Statement by person ceasing to hold office as auditor

(1) Where an auditor of an unquoted company ceases for any reason to hold office, he must deposit at the company's registered office a statement of the circumstances connected with his ceasing to hold office, unless he considers that there are no circumstances in connection with his ceasing to hold office that need to be brought to the attention of members or creditors of the company."

notified to the audit authority. The auditor is also required either to state that there are no circumstances connected with his or her resignation that need be brought to the attention of members or creditors of the company, or to set out what are the circumstances for his resignation to be circulated by the company.²⁴ The publication of the auditor's resignation statement was proposed by the UK CLR²⁵ and was accepted by the UK Government.²⁵ The rationale was that the publication will enable investors to understand the reasons for the resignation of the auditor and will result in greater understanding and transparency and reduce speculations against the company or the auditors.

- 2.12 In Australia, an auditor of a company may resign by way of a written notice given to the company and at the same time, to the ASIC applying for consent to the resignation and stating the reasons for the application.²⁷ Currently, the resignation takes into effect once ASIC has consented to the resignation which by virtue of section 331 AC (5) starts:
- (a) on the day (if any) specified for the purpose in the notice of resignation; or
 - (b) on the day on which ASIC gives its consent to the resignation; or
 - (c) on the day (if any) fixed by ASIC for the purpose;
- whichever occurs last.

²⁴ Section 519(2) and (3) of the Companies Act 2006 which states as follows: " (2) If he considers that there are no circumstances in connection with his ceasing to hold office that need to be brought to the attention of members or creditors of the company, he must deposit at the company's registered office a statement to that effect and (3) Where an auditor of a quoted company ceases for any reason to hold office, he must deposit at the company's registered office a statement of the circumstances connected with his ceasing to hold office."

²⁵ Company Law Reform White Paper, March 2005, at page 27.

²⁶ See also the UK Company Law Reform Bill 2005, Clause 505 (1) states that an auditor's notice of resignation should be accompanied with a statement of the circumstances connected with his resignation. Clause 505 (3) also states that an auditor may request the company to circulate a statement in writing of the circumstances connected with his resignation to its members before the meeting convened on his requisition or before any general meeting at which his term of office would have expired or at which it is proposed to fill the vacancy caused by his resignation. Clause 504 United Kingdom Law Reform Bill, an auditor who resigns the company must within 14 days of the deposit of a notice of resignation send a copy of the notice to the registrar of companies.

²⁷ Section 331 AC (2) [Resignation] An auditor of a registered scheme may, by notice in writing given the responsible entity, resign as auditor of the scheme if:

(a) the auditor:

(i) has, by notice in writing given to ASIC, applied for the consent to the resignation and stated the reasons for the application; and
 (ii) has, at or about the same time as giving the notice to ASIC, given the responsible entity notice in writing of the application to ASIC; and
 (b) ASIC has given its consent.

ASIC requires the auditor to write in for its consent and statements made by the auditor in relation to his resignation are not admissible in civil or criminal proceedings against the auditor.²⁸

- 2.13 Under the present section 172(14) and (15) of the Companies Act 1965, an auditor may resign *only when a new auditor is appointed and only at a general meeting of the company and the resignation will only be effective on the appointment of another auditor*. The CLRC is of the view that section 172(14) and (15) should be amended. Whilst the CLRC is aware that the reason for this statutory provision is to ensure that a company will continue to have an auditor at all times, this should not be a reason to force an auditor to stay in office. It is the directors' responsibility to ensure that a new auditor is appointed if the existing auditor wishes to resign. Furthermore, while section 172(15) states that the directors shall call a general meeting as soon as is practicable for the purposes of appointing a new auditor, there is no time frame specified within which the directors must call and convene a general meeting. To ensure that that the company's interest is not prejudiced, the CLRC recommends that if the auditor ceases to hold office due to a resignation, the directors must proceed duly within 21 days from the date of the deposit of a notice of resignation to convene a meeting for a day not more than 28 days after the date on which the notice convening the meeting is given. Every director who failed to take all reasonable steps to secure that a meeting was convened as mentioned above is guilty of an offence and liable to a fine. The effective date of resignation is at the end of 21 days from the time the notice is deposited with the company.

²⁸ Section 329(7) of the Corporations Act 2001.

- 2.14 The recent Companies (Amendment) Act 2007²⁹ imposes a duty on the auditor who is removed from office and who sends a written representation to the company or who has resigned, to submit the written representation to the Registrar and the Stock Exchange if the company is a public listed company. The information must be submitted to the regulators within 7 days of the submission of the written representation or resignation to the company. The fact that the auditor is required to give reasons for his resignation or declining reappointment would be in the interest of the shareholders of the company who would be able to hear directly from the auditor on this decision since the appointment of the auditor was initially approved by the shareholders at the general meeting. The CLRC noted that the High Level Finance Committee recommended that auditors *should be required* to give reasons for the resignation or non-renewal of services, as it provides an early warning signal to the investors and the regulators about the company's financial situation. The CLRC noted that under the current section 172 of the Companies Act 1965, an auditor who is to be removed from office *may* submit a written representation to the company and request that the written representation be sent to every member who is entitled to receive the notice of meeting. There is however, no similar provision in the case of a resignation. The CLRC thus recommends that a resignation statement should also be required to be submitted to the company and the company should be required to make the statement available to the shareholders.
- 2.15 In terms of the content of the statement, the CLRC is of the view that the statement on ceasing to hold office must be worded in such a way so as to state the reasons for the resignation or removal or where the auditor considers that there are no circumstances in connection with his ceasing to hold office that need to be brought to the attention of members or creditors of the company. Members of the company

²⁹ Clause 19 of the Companies (Amendment) Act 2007 introducing section 172A into the Companies Act 1965.



should be furnished with a statement of the reason for ceasing to hold office especially in relation to the removal of an auditor or his resignation in order to promote greater transparency and good corporate governance practices. This will resolve problems in relation to the rights of an auditor to resign whilst ensuring that there is sufficient information given to the company and *via* the regulatory authority, to the public of the reasons for the auditor's resignation or the auditor's refusal of reappointment.

RECOMMENDATIONS

2.16 The CLRC recommends that:

- (a) the existing requirement as to the appointment of an auditor for both public and private companies should be retained if the mandatory audit is retained. However, if audit or AGM is no longer required for private companies, the auditors are to be appointed by directors if shareholders do not appoint them and the duration of appointment of auditors is in accordance to the terms of appointment or until they are removed by shareholders at a general meeting or until they resign.
- (b) In the case of the resignation of auditors, the current statutory provision that requires the resignation to be effective upon the appointment of a new auditor and only if the resignation is made at the general meeting, should be deleted. The effective date of resignation would be at the end of 21 days from the time the notice is deposited with the company. The directors must proceed duly within 21 days from the date of the deposit of a notice of resignation to convene a meeting for a day not more than 28 days after the date on which the notice convening the meeting is given. Every director who failed to take all reasonable steps to secure that a meeting was convened as mentioned above is guilty of an offence and liable to a fine.

- (c) where the auditor resigns, the auditor should be required to submit the resignation statement to the company in addition to the duty to inform the regulators upon ceasing to hold office as the auditor and the company should be required to provide the shareholders with the statement. The auditor is required to either state that there are no circumstances connected with his or her resignation that need be brought to the attention of members or creditors of the company, or to set out what are the circumstances for his resignation to be circulated by the company.
- (d) the existing provision on the removal of auditor is to be retained.
- (e) there should not be a codification of the mandatory rotation of audit firms and that rules relating to mandatory audit rotation should continue to be a matter of best practice.

Questions for Consultation

Question 1:

Do you agree that an auditor should be required to submit a written representation in relation to his removal or resignation to the company in addition to the regulators? If yes, do you agree that the auditor is required to either state that there are no circumstances connected with his or her resignation that need be brought to the attention of members of the company, or to set out what are the circumstances for his resignation?

Question 2:

Do you agree that the company should be required to circulate the notice of resignation accompanied by the statement to the shareholders?

Question 3:

Do you agree that the auditor's resignation is to be effective at the end of 21 days from the time the notice is deposited with the company?

Question 4:

Do you agree that the auditor's resignation should be subject to the regulator's approval?

Question 5:

Do you agree that the directors must proceed duly within 21 days from the date of the deposit of a notice of resignation to convene a meeting for a day not more than 28 days after the date on which the notice convening the meeting is given?

Question 6:

Do you agree that every director who failed to take all reasonable steps to secure that a meeting was convened as mentioned above is guilty of an offence and liable to a fine?

Question 7:

What are your views in relation to reliance on best practices in relation to mandatory rotation of audit firms?

C Auditors' Rights And Duties

2.17 As audit is intended to provide an independent third party verification of the company's accounts, the CLRC also deliberated on the rights of an auditor in relation to access to a company's information, the right to attend general meetings and be heard on any part of the business of the meeting to which the audit relates. These rights are very important to ensure that auditors' receive the cooperation required to assess the company's accounts so that they may make an assessment on whether or not the company's accounts have been prepared to reflect a true and fair view of the company's financial position. In addition, the Listing Requirements of Bursa Malaysia Securities Berhad also provides the external auditor with the right to convene an audit committee meeting to consider any matter that

the external auditor believes should be brought to the attention of the board.³⁰ The right to request for a meeting of the board is particularly relevant in view of auditors' duty of care.³¹ The CLRC is satisfied that the existing statutory provisions in the Companies Act 1965 on the above matters i.e., section 174(4), (5), (7) and section 174A are sufficient to assist auditors in the performance of their duty. However, in view of the recommendation of the CLRC in CD 3 that a written resolution is to be made available only for a private company, the CLRC recommends a statutory provision similar to section 502 of the UK Companies Act 2006 be enacted.³²

- 2.18 The scope of auditors' duties is found under section 174 of the Companies Act 1965. The current regime relies on the statutory provision to specify the general duty on auditors to report to shareholders on the company's accounts on whether the company's accounts have been prepared so as to give a true and fair view of the company's accounts, on whether the company's accounts have been prepared so as to give a true and fair view of the company's affairs and whether the company's accounts has been prepared in accordance with the applicable approved accounting standards.³³ In the performance of their duty, the standard of care expected of auditors is determined by the auditing standards which are issued by the Malaysian Institute of Accountants (MIA) to provide guidance on circumstances leading to the issuance of a particular type of audit opinion as well as on work to be

³⁰ Paragraph 15.25, Listing Requirements of Bursa Malaysia Securities Berhad 2001.

³¹ *Daniels v Anderson* (1995) 13 ACLC 614.

³² 502 Auditor's rights in relation to resolutions and meetings

(1) In relation to a written resolution proposed to be agreed to by a private company, the company's auditor is entitled to receive all such communications relating to the resolution as, by virtue of any provision of Chapter 2 of Part 13 of this Act, are required to be supplied to a member of the company.

(2) A company's auditor is entitled-

(a) to receive all notices of, and other communications relating to, any general meeting which a member of the company is entitled to receive,

(b) to attend any general meeting of the company, and

(c) to be heard at any general meeting which he attends on any part of the business of the meeting which concerns him as auditor.

(3) Where the auditor is a firm, the right to attend or be heard at a meeting is exercisable by an individual authorised by the firm in writing to act as its representative at the meeting.

³³ Section 174(2) of the Companies Act 1965.

done in arriving at an audit opinion. The MIA auditing standards are based on and aligned to the International Standards on Auditing and are continuously updated in line with international developments in capital markets and auditing standards. The auditors are also guided by the Bye-laws (on professional conduct and ethics) issued by the Malaysian Institute of Accountants (MIA) and must rely on their professional training in giving their professional opinion in relation to whether or not the company's accounts give a true and fair view of the company's financial position. Nonetheless, there are views that codification of the standard of care expected of auditors will provide certainty and clarity. Although the CLRC is of the view that the current reliance on best practice is appropriate, it is possible for the statutory provision to state that auditors are required to comply with applicable auditing standards in the performance of their duty to report on the accounts.

- 2.19 The question as to whom auditors owe their duty has been discussed and developed through case law under liability for economic loss due to negligent misstatement. This issue was also considered by the UK CLR where it was suggested that either one of these methods be adopted to determine the categories of persons to whom a duty of care should be owed: firstly, stating the specific categories of persons to whom a duty is owed (which might include existing shareholders and creditors, prospective investors and creditors and perhaps employees) or, secondly, to establish by statute certain criteria by which it should be determined whether an auditor owed a duty of care to a particular person. Nonetheless, the UK CLR was of the view that there may be difficulties in doing so. It was suggested in the report that if such difficulties could not be dealt with, it would be wiser to leave the *Caparo Industries v Dickman*³⁴ rule in place, with the possibility of its development by the courts on case-by-case basis. *Caparo* and subsequent cases laid down the following rules:

³⁴ *Caparo Industries v Dickman* [1990] AC 605 HL.



- (a) the statutory provisions in the Companies Act establishes a relationship between those responsible for the accounts (directors) or for the report (auditors) with the company. Currently auditors owe a duty of care in the performance of their audit functions under the Act only to actual shareholders in the company but only in relation to their power to safeguard their interest in the company. The duty does not extend to the members of the public in the absence of a 'special relationship';³⁵
- (b) a 'special relationship' exists where the claimant can show that the auditor had contemplated that the accounts and reports would be communicated to the claimant either as an individual or member of a group specifically in connection with specific transactions (e.g. in a prospectus inviting investment) and that the claimant would probably rely on it in deciding whether or not to enter into the transaction;³⁶
- (c) in assessing whether the auditor had contemplated reliance, the auditor will be assessed based on what they actually knew and that which a reasonable person in their position would know; and³⁷
- (d) *Caparo's* decision does not mean that the members of the public i.e. the investors or outsiders (for example financiers or the regulators) will not be able to sue the auditors since it is possible for investors to sue auditors if there has been an express acceptance of liability by the auditors *vis-à-vis* the claimant.

³⁵ *Caparo Industries v Dickman* [1990] AC 605 HL.

³⁶ In a corporate group structure, the auditors of a subsidiary company also owes a duty of care to the parent company as the auditors are aware that the subsidiary's accounts will be considered to reflect a true and fair view of the groups' financial position: *Barings Plc v Coopers & Lybrand* [1997] 2 BCLC 427, CA. However, the liability is only in relation to the normal use of the subsidiary's accounts by the parent company for example the decision to declare dividends and bonuses to senior staff: *Barings Plc v Coopers & Lybrand (No.1)* [2002] 2 BCLC 364. In *Esanda Finance Corporations Ltd v Peat Marwick Hungerfords* (1997) 23 ACSR 71; 15 ACLC 483, Esanda, a finance company, lent money to a group of companies after reviewing its audited accounts. The borrower was unable to meet its commitments and Esanda sued Peat Marwick alleging that they had been negligent in conducting the audit and that the negligence had caused Esanda's loss. Peat Marwick denied that it owed a duty of care to Esanda. The court held that Peat Marwick did not owe a duty of care to Esanda based on considerations of proximity. See also *Leslie Wong Kok Chin v Singapore Society of Accountants* [1990] 1 MLJ 456; *Ikumene Singapore Pte Ltd v Leong Chee Leng* (1992) 2 SLR 890.

³⁷ In deciding whether or not there is an assumption of liability, it is not required that the auditor should consciously have assumed responsibility as the auditor will be assumed to know what they actually knew and that which a reasonable person in their position would know: *Electra Private Equity Partners v KPMG Peat Marwick* [2001] 1 BCLC 589.

- 2.20 Another issue is in relation to contributory negligence where the auditors claim that the failure of the company directors and employees to cooperate contributed to their breach of duty. In *Daniels t/a Deloitte Haskins & Sells v AWA Ltd.*,³⁸ the company sued its auditors for negligence and they in turn argued that there was contributory negligence on the part of the directors of the company. The Court of Appeal held that the auditors were negligent but there was contributory negligence on the part of the company due to the conduct of the chief executive officer and the senior executives. The UK CLR proposed that if the non cooperation had contributed to the misstatements in the auditors' report,³⁹ the auditors would be entitled to claim contributory negligence when they are sued by third parties or when there is a claim by the company.⁴⁰
- 2.21 The CLRC would like to seek views whether there should be codification of the persons to whom the auditors' owe a duty of care.

RECOMMENDATIONS

- 2.22 The CLRC recommends that:
- (c) the statutory provision relating to rights of an auditor in relation to access to the company's information, the right to attend general meetings and be heard on any part of the business of the meeting to which the audit relates be retained; and

³⁸ [1995] 13 ACLC 614.

³⁹ This is in view of the duty that an officer commits an offence if he knowingly or recklessly makes a statement to the auditor which conveys any the information or explanation which is misleading, false or deceptive in any material particular. The CLR proposed that this duty should be extended to all employees of the company and that directors should be subject to a duty to volunteer information which they realise or ought to have realised is needed by the auditor. However the criminal liability for directors would only apply if the director knew that the information was material. See Final Report, para 8.119-8.122.

⁴⁰ Final Report, Para 8.139-8.140.

- (d) the current regime that relies on statute to state the general duty of auditors to report whether the accounts give a true and fair view of the company's financial position while relying on best practice and self-regulation to provide guidance on how the assessment of whether the accounts give a true and fair view of the company's financial position should be retained.

Questions for Consultation

Question 8:

Do you agree that the current regime that relies on statute to state the general duty of auditors to report whether the accounts give a true and fair view of the company's financial position while relying on best practice and self-regulation to provide guidance on how the assessment of whether the accounts give a true and fair view of the company's financial position should be retained?

Question 9:

What are your views on the codification of the categories of persons to whom auditors' owe a duty of care?

3. OVERSIGHT OF THE AUDITING PROFESSION

- 3.1 Large scale financial scandals involving high profile public listed corporations such as Enron and Worldcom in the United States and Livedoor in Japan, has brought to fore the issue of oversight of auditors. Locally, accounting and other financial irregularities in local companies raise significant issues relating to the audit process.
- 3.2 The assurance function carried out by an external auditor of a company is critical in maintaining shareholders confidence in the management of a company and more so where the concerned shareholders are not part of the management of the company, as these shareholders would not be privy to the same level of information that is made available to the company's management. Such shareholders would

therefore largely rely on the assurance function that is carried out by the company's external statutory auditor. Apart from shareholders, regulators also rely on the assurance function that is carried out by the company's external statutory auditor for the purposes of carrying out its supervisory functions.

3.3 The CLRC recognises that having in place a regulatory framework that ensures that a company's external auditor maintains and continuously carries out a high quality assurance is a vital element in maintaining investor confidence and in protecting minority interest. Further, the CLRC is of the view that high quality assurance by a company's external auditor is a cornerstone for good corporate governance.

3.4 Many factors contribute towards the quality of the assurance that is provided for by the company's external statutory auditor. This includes the-

- Statutory provisions in relation to the appointment, removal, rights and duties of the company's external statutory auditor, which have been discussed previously in this paper, and
- oversight of the auditing profession in relation to qualification, independence, competency, discipline of the members of the auditing profession and auditing standard setting as well as other oversight mechanisms which shall be discussed further in this part of the paper.

3.5 Currently the auditing profession in Malaysia operates within a regulatory framework that combines both legal and self-regulation. Whilst an auditor is appointed by the company, to qualify for the appointment, auditors must be registered by the professional bodies as required in accordance with the criteria laid down under the Accountants Act 1967. In accordance with the provisions of the Accountants Act, registration with MIA is mandatory in order for a person to engage in public

accounting practice.⁴¹ In addition, an auditor must also obtain the approval of the Minister for Finance under section 8 of the Companies Act 1965. The Minister for Finance is also authorised to delegate this approval function. This registration and approval framework as discussed above assist in ensuring that only fit and proper persons shall be appointed as a company's external auditor and provides an oversight mechanism over the company's external auditor's educational and professional requirements and professional ethical standards. The professional bodies are also responsible for regulating the professional conduct and ethics of their members. However, the CLRC notes that there is no independent oversight body that operates independently of the auditing profession to monitor auditor's ongoing compliance with professional ethical standards. Currently the task of monitoring auditor's ongoing compliance with professional ethical standards is carried out by the Malaysian Institute of Accountants (MIA).

3.6 Where auditing standards are concerned, the approved auditing standards in Malaysia, Malaysian Standards on Auditing (MSA), are issued by the Malaysian Institute of Certified Public Accountants (MICPA) and the Malaysian Institute of Accountants (MIA).⁴² The International Auditing Guidelines (IAG), and subsequently International Standards on Auditing (ISA) and International Auditing Practice Statements (IAPS), had been adopted as the basis for the Malaysian approved auditing standards/guidelines. Where an ISA / IAPS contain requirements which are significantly different from Malaysia's statutory requirements, guidance on such differences will be provided in an explanatory foreword to the ISA / IAPS.

⁴¹ The Accountants Act 1967 prescribes a list of qualifications which are approved for admission as members of MIA:

- accredited Bachelor of Accountancy degrees from Malaysian universities;
- membership of recognised professional bodies, of which MICPA is the only Malaysian body;
- MIA Qualifying Examination, conducted by higher education institutions prescribed in the Act or the MICPA.

⁴² The two bodies have formed a joint working group to undertake standard setting responsibilities.

- 3.7 The CLRC notes that current international trends on auditor oversight advocate the view that the oversight mechanism of auditors must be independent from the accounting bodies that further the interest of auditors. The view that an accounting body should not regulate matters concerning auditors' independence has become even more persuasive with the establishment of the Public Company Accounting Oversight Body (PCAOB) in the United States in 2002. PCAOB was created in response to the Enron and Worldcom financial scandals. Prior to the creation of PCAOB, the audit industry in the United States was essentially self-regulated through the Public Oversight Board, a private organisation whose members were appointed by the auditing industry. PCAOB's main functions include registering public accounting firms, promulgating auditing standards, inspecting public accounting firms and enforcing accounting standards. Thus in the United States, auditor oversight is conducted solely by an independent statutory body.
- 3.8 The other approach used in respect of auditor oversight is dividing auditor oversight between an independent statutory body and a self-regulatory professional body as in the case of the United Kingdom (UK). In the UK, the independent Financial Reporting Council (FRC) is responsible for promoting confidence in corporate reporting and governance and is assisted by six (6) bodies i.e. the Professional Oversight Board for Accountancy (POBA), Accountancy and Actuarial Discipline Board (AIDB), Audit Practices Board (APB), Audit Inspection Unit (AIU), Board for Actuarial Standards (BAS) and Financial Reporting Review Panel (FRR)). Where audit and accounting standards are concerned, the APB sets out the basic procedures that an auditor is required to comply with and establish ethical standards in relation to the independence, objectivity and integrity of auditors. The APB is funded by professional bodies through CCAB bodies, the Governor of the Bank of England and the London Stock Exchange. Whilst standards issued do not carry the force of law,

the constituent bodies of CCAB have agreed to enforce them within their membership. Under the UK Companies Act 1989, the major professional bodies have been delegated responsibility for registration of company's auditors. The Act sets out the criteria the bodies must address when assessing an application for registration. The investigating role over irregularities in a financial report is carried out by the Financial Reporting Review Panel (FRRP) and the Department of Trade and Industry (DTI) if the investigation unearths any irregularities, the auditor may be reported to the professional bodies that will carry out the disciplinary process.

- 3.9 The CLRC noted that although the UK CLR had recommended for the establishment of the Accountancy Foundation,⁴³ the UK Government's response was that there was no case for the creation of a new body especially in view of the increasing importance of International Accounting Standards (IAS) and the changes already made to the FRC and the responsibilities of the bodies that fall under it.⁴⁴
- 3.10 In Australia, the recently established independent statutory body, the Australian Auditing and Assurance Standards Board, has authority for setting standards and is subject to oversight by another independent statutory body, the Financial Reporting Council. The investigation and registration of auditors is conducted by a governmental agency, the ASIC, while another government entity, the Companies Auditors and Liquidators Disciplinary Board, is charged with the overseeing the disciplinary issues of the auditors. Additionally, professional bodies continue to impose their own standards on members and retain some disciplinary powers.

⁴³ Para 8.124, *Auditors' Independence - Modern Company Law for a Competitive Economy Final Report*, 2001.

⁴⁴ Company Law Reform Cmnd 6456. (March 2005).

⁴⁵ Technical Committee of the International Organization of Securities Commissions (October 2002).



- 3.11 The CLRC notes that whilst there are different approaches to auditor oversight the approaches have a common component in that they advocate the concept of independent regulation of the auditing profession.
- 3.12 Further, the CLRC noted that the *Principles for Auditor Oversight* published by the International Organization of Securities Commissions (IOSCO) identifies the characteristics of an effective oversight to include the following:
- (a) A mechanism to require that auditors have proper qualifications and competency before being licensed to perform audits, and maintain professional competence. A mechanism also should exist to withdraw authorization to perform audits of publicly traded companies if proper qualifications and competency are not maintained. IOSCO believes establishing qualification requirements and requiring maintenance of professional competency should improve the quality of auditing. Moreover, the risk that authorization can be revoked for failure to have or maintain the necessary qualification should be an incentive for compliance and adherence to auditing standards.
 - (b) A mechanism to require that auditors are independent of the enterprises that they audit, both in fact and in appearance. Effective standards, regular assessments, and regulatory oversight generally increases the likelihood that independence is maintained.
 - (c) A mechanism should exist to provide that a body, acting in the public interest, provides oversight over the quality and implementation of auditing, independence, and ethical standards used in the jurisdiction, as well as audit quality control environments.
 - (d) A mechanism should exist to require auditors to be subject to the discipline of an auditor oversight body that is independent of the audit profession, or, if a

professional body acts as the oversight body, is overseen by an independent body. Such an auditor oversight body must operate in the public interest, and have an appropriate membership, an adequate charter of responsibilities and powers, and adequate funding that is not under the control of the auditing profession, to carry out those responsibilities. An auditor oversight body should establish a process for performing regular reviews of audit procedures and practices of firms that audit the financial statements of listed public companies. This oversight process may be performed in coordination with similar quality control mechanisms that are in place within the audit profession, provided the oversight body maintains control over key issues such as the scope of reviews, access to and retention of audit work papers and other information needed in reviews, and follow-up of the outcome of reviews. Reviews should be conducted on a recurring basis, and should be designed to determine the extent to which audit firms have and adhere to adequate quality control policies and procedures that address all significant aspects of auditing. Matters to be considered include:

- (i) Independence, integrity and ethics of auditors
- (ii) Objectivity of audits
- (iii) Selection, training, and supervision of personnel
- (iv) Acceptance, continuation and termination of audit clients
- (v) Audit methodology
- (vi) Audit performance, that is, compliance with applicable generally accepted
- (vii) Auditing standards

- (viii) Consultation on difficult, contentious or sensitive matters and resolution of differences of opinion during audits
 - (ix) Second partner reviews of audits
 - (x) Communications with management, supervisory boards and audit committees of audit clients
 - (xi) Communications with bodies charged with oversight over the financial reporting process, for example, on matters such as regulatory inquiries, changes in auditors, or other matters as may be required
 - (xii) Provisions for continuing professional education. An auditor oversight body also should address other matters such as professional competency, rotation of audit personnel, employment of audit personnel by audit clients, consulting and other non-audit services, and other matters as deemed appropriate.
- (e) An auditor oversight body should have the authority to stipulate remedial measures for problems detected, and to initiate and/or carry out disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate.
- (f) In relation to companies operating or listing on a cross-border basis, IOSCO members are encouraged to provide each other, whether directly or through coordinating with the auditor oversight body in their jurisdiction, with the fullest assistance permissible in efforts to examine or investigate matters in which improper auditing may have occurred and on any other matters relating to auditor oversight. Members are also encouraged to explore approaches to enhance cooperation among jurisdictions.

RECOMMENDATION

3.13 The CLRC is of the view that consideration should be given to the establishment of an independent Auditing Oversight Body. This proposed body would have some features similar to that of the Public Company Accounting Oversight Body (PCAOB) of the United States. It is proposed that the members of this body should comprise persons other than members from the professional accounting bodies such as regulators, investor associations and industry associations. This proposed broad based membership is to ensure that public interest will be adequately represented in the proposed body. This proposed body should be responsible for all matters pertaining to the audit industry or whether its remit be confined only to non-licensing matters as licensing of auditors is already dealt with by section 8 of the Companies Act 1965. Matters which should be within the scope of functions of the oversight body would include those referred to above. This proposed body will co-exist with professional accounting bodies which would be responsible for the professional functions of the audit profession.

Question for Consultation

Question 10:

What are your views as to the establishment of an independent statutory body that will be responsible for auditor oversight?

This Page Is Intentionally Left Blank

